



Guideline

Income Tax

Beginning entrepreneur income tax deductions

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Introduction

This guideline explains the income tax deductions available to an entrepreneur who sells or leases a revenue-producing enterprise to a beginning entrepreneur.

Entrepreneur defined

When used by itself, the word “entrepreneur” means an individual, estate, trust, partnership, corporation, or limited liability company owning a revenue-producing enterprise located in North Dakota, provided the revenue-producing enterprise was not acquired solely for the purpose of qualifying for the beginning entrepreneur income tax deductions. Spouses who jointly own a revenue-producing enterprise are considered one entrepreneur.

Beginning entrepreneur defined

When used together, the words “beginning entrepreneur” mean an individual who:

1. Is at least eighteen years of age;
 2. Is a legal resident of North Dakota;
 3. Has a net worth (including the net worth of a spouse and/or dependents) of less than \$100,000;
 4. Intends to use the purchased or leased revenue-producing enterprise for business purposes;
 5. Receives more than one-half of annual gross income from a revenue-producing enterprise, unless the individual initially commences business during the tax year for which a beginning entrepreneur deduction will be taken;
- AND**
6. Has had adequate training, by experience or education, in the type of business which the individual wishes to conduct through the purchased or leased revenue-producing enterprise.

An individual who qualifies as a beginning farmer under North Dakota Century Code § 57-38-67(2) is excluded from the definition of a beginning entrepreneur.

Spouses jointly purchasing or leasing a revenue-producing enterprise. Spouses who jointly purchase or lease a revenue-producing enterprise from an entrepreneur are considered one beginning entrepreneur.

Calculating net worth. The net worth must be determined as of the date the contract for purchase or lease is executed. To calculate net worth, add up the fair market value of all assets and subtract the total amount of all liabilities. However, the fair market value (and related liabilities) of a principal residence, one personal or family motor vehicle, and any household and personal goods (such as furniture, appliances and clothing) must be excluded in calculating net worth.

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Revenue-producing enterprise

The words “revenue-producing enterprise” mean real property (including land, buildings, and any improvements thereto) and equipment located on the real property, or any personal property used or useful in a business, comprising an entire trade or business located in North Dakota that is not prohibited by the laws of North Dakota.

Income tax deductions

There are three separate income tax deductions available to an entrepreneur for selling or leasing a revenue-producing enterprise to a beginning entrepreneur. The amount of any deduction is limited to the amount included in taxable income for U.S. income tax purposes for the year in which the deduction is claimed. The three deductions, along with the provisions unique to each one, are described below.

- **Deduction for gain from sale of revenue-producing enterprise.** If an entrepreneur sells a revenue-producing enterprise to a beginning entrepreneur, the entrepreneur may deduct the gain from the sale in calculating North Dakota taxable income. If the sale is made under a contract that provides for installment payments, the deduction is allowed for each tax year in which part of the gain is required to be reported for U.S. income tax purposes.
- **Deduction for interest income from a contract for deed.** If an entrepreneur sells a revenue-producing enterprise to a beginning entrepreneur under a contract for deed having a term of at least ten years, and if the interest rate specified in the contract for deed is equal to or less than the minimum interest rate required under U.S. income tax law in installment (or deferred) payment contracts to avoid the imputing of interest, the entrepreneur may deduct the interest income derived from the contract in calculating North Dakota taxable income.
- **Deduction for net income from a lease contract.** If an entrepreneur leases a revenue-producing enterprise to a beginning entrepreneur under a written lease contract having a fixed term of at least three years, the entrepreneur may deduct the net income (up to \$25,000 per tax year) under the contract in calculating North Dakota taxable income. An entrepreneur is ineligible for this deduction if the entrepreneur cancels an existing lease contract with another person solely for the purpose of taking advantage of this deduction.

If a lease contract contains provisions that provide for the renewal of the contract on an annual basis, the renewal period or periods do not count toward meeting the minimum three-year lease term, nor is the net rental income received for the annual period or periods eligible for this deduction. For example, if a lease contract provides for an initial fixed three-year lease period with an option to renew the contract on an annual basis at the end of the three-year period, this deduction is only allowed for net rental income received for the initial fixed three-year lease period.

Allocation of deduction in the case of a pass-through entity or joint ownership by spouses. If the entrepreneur is a pass-through entity such as a partnership, the allowable deduction(s) must be allocated to the entity’s owners based on their respective interests. If the entrepreneur consists of two spouses who jointly own the revenue-producing enterprise, and if the spouses are required to file separate North Dakota income tax returns, the deduction(s) must be allocated to the spouses based on their respective interests.

Optional method of filing limitation

Where an entrepreneur is an individual, estate or trust, the deductions are allowed only if the optional method of filing is used. An individual may claim the deductions only on Form ND-2 (Optional method), and an estate or trust may claim the deductions only on Form 38, Schedule 2 (Optional method). The deductions are not allowed on

Form ND-1 or Form 38, Schedule 1. ***Important: Because of this limitation, the tax liability should be calculated under both methods of filing—Form ND-1 and ND-2 (if an individual) or Form 38, Schedule 1 and 2 (if an estate or trust)—to see which method yields the lowest tax for the year.***

Beginning entrepreneur statement

An entrepreneur must obtain a Beginning Entrepreneur Statement from the Office of State Tax Commissioner which must be completed and attached to the entrepreneur's North Dakota income tax return. The Beginning Entrepreneur Statement has three parts: Part 1 (Beginning Entrepreneur Certification) must be completed in all cases by the individual who qualifies as a beginning entrepreneur. Part 2 (Entrepreneur Rental Certification) must be completed by an entrepreneur only if a deduction for net income from a lease contract is claimed. Part 3 (Net Worth Statement) must be completed in all cases by the individual who qualifies as a beginning entrepreneur.

The entrepreneur must attach the completed Beginning Entrepreneur Statement to the entrepreneur's North Dakota income tax return for each tax year in which a deduction is claimed. The entrepreneur may make copies of the statement, as needed, for this purpose. The entrepreneur should also keep a copy.

Need help?

Phone: (701)328-1032
Speech/hearing impaired — call us through Relay North Dakota at 1-800-366-6888
E-mail: individualtax@state.nd.us
Web site: www.nd.gov/tax
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